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THE RIGHTS OF TRUSTEES TO DERIVE INDIRECT PROFITS FROM THE HANDLING OF TRUST FUNDS.

For many years it has been a well established rule in equity that no trustee may lawfully appropriate to himself any profits that may have accrued to him directly from the handling or possession of the trust funds belonging to a *cestui que trustent.* The general rule covering transactions of this nature is well set forth in volume 39 of the Encyclopedia of Law and Procedure (pp. 296, 297), as follows:

> "In administering the trust, the trustee must act for the beneficiaries, and not for himself, in antagonism to the interest of the beneficiaries; he is prohibited from using the advantage of his position to gain any benefit for himself at the expense of the *cestui que trustent,* and from placing himself in any position where his self interest may conflict with his duties as trustee. And so it is the rule that, except his lawful compensation, a trustee will not be permitted to derive any benefit out of the trust, and that the *cestuis que trustent* may successfully claim any profits made out of the office of trustee or the use of trust funds."

A great many years ago the New York courts in Conroy *v.* Port Henry Iron Company (12 Barb. 27) laid down the general rule that has been ever since followed to the effect that a trustee is not allowed to make any gain, profit or advantage from the use of the trust funds. A glance at some of these later New York cases may be of some practical benefit at this point:

In Ogden *v.* Murray (39 N. Y. 202) the Court of Appeals spoke as follows:

> "This brings the case within the rule, which rests in the soundest wisdom, and is sustained by the best considera-

tion of the infirmities of our human nature, and called for by the only safe protection of the interests of *cestui que* trusts or beneficiaries, viz.:

"That trustees and persons standing in similar fiduciary relations, shall not be permitted to exercise their powers and manage or appropriate the property of which they have control for their own profit or emolument, or as it has been expressed, 'shall not take advantage of their situation to obtain any personal benefit to themselves at the expense of their *cestui que* trust.'

"This by no means assumes that the trustees were not in this case in the actual exercise of the highest integrity. I cannot for a moment doubt that in reference to the particular cases before us; but the principle is one of great importance, and *it forbids any inquiry into the honesty of a particular case.*"

Again in Ten Eyck *v.* Craig (62 N. Y. 410) the same court observed:

"The rule which prohibits a trustee from purchasing the property of a *cestui que* trust stands upon the proposition stated by the Chancellor in Whichcote *v.* Lawrence (3 Ves. 740), that one who undertakes to act for another in any matter shall not in the same matter act for himself. * * * The rule is inflexible that he shall not place himself in a position where his interest is or may be in conflict with his duty. The reason of the rule as remarked by Kent, J., in Bergen *v.* Bennett, Cai. Cas. 19, 2 Am. Dec. 281, is to bar the more effectually every avenue to fraud."

In Young *v.* Barker (141 App. Div. 808) the Appellate Division, Second Department, observes:

"That there is no question of the principle than which it is stated nothing is better settled than that those standing in a fiduciary capacity shall not take advantage of their situation to obtain any personal benefit to themselves at the expense of their *cestui que* trust."

Surrogate Fowler, of New York City, in a recent case (*In re* Randolph, 134 N. Y. Supp. 1117) observed that in his court trustees should be held to the highest—not the lowest standard under the laws.

Particular attention should be paid to two general principles which are brought out in two of the cases cited above. That

is, where the Court of Appeals in Ogden *v.* Murray (*ante*), states specifically that the general rule forbids any inquiry into the honesty of a particular case. In other words, for the purpose of administering trusts the good intentions or absence of any fraudulent intent on the part of the trustees does not alter in the slightest degree the strict inflexibility of the general rule. And then again, attention should be called to the rule promulgated by Surrogate Fowler in the case cited above (*In re* Randolph, *ante*), to the effect that trustees will be held to the highest standard of mortality and equity under the laws.

Finally, we venture to call attention to another statement of the general rule as presented by the Supreme Court of the United States in Magruder *v.* Drury (235 U. S. 106) as follows:

> "It is a well settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate and not to permit his personal interest to in any wise conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity. * * * It makes no difference that the estate was not a loser in the transaction, or that the commission was not more than the services were reasonably worth. It is the relation of the trustee to the estate which prevents his dealing in such way as to make a personal profit for himself."

In the opinion of the writer, no court has laid down a broader or more equitable general rule covering the conduct of trustees in their administration of trust estates than was laid down by the New Jersey Court of Equity in Jacobus *v.* Munn (37 N. J. Eq. 48). In that case the court laid down the principle that a trustee will not be allowed to retain any benefit nor any bonus or present given him by third parties with whom he has dealt as trustee.

Now, having the general rule betore us, let us go one step further, and inquire what are the basis reasons which have led the court to adopt the stringent rule governing manner in which trustees must execute the duties of their trust position. This was touched upon briefly by our Court of Appeals in

Fulton *v.* Whitney (66 N. Y. 167), that court having specifically stated that in all such cases *it is wholly unnecessary to allege or find actual fraud on the part of the trustee,* and proceeding further, stated that "the object of the rule which precludes trustees from dealing for their own benefit in matters to which their trusts relates, is to *prevent secret frauds by removing all inducements to attempt them.*"

The Illinois Supreme Court in City of Chicago *v.* Tribune Company (248 Ill. 242) stated the object of the rule is to preclude the possibility of trustees being exposed to the temptation of acting contrary to the interests of the party to whom he owes a duty.

The Iowa Supreme Court (*In re* Carmody's Estate, 145 N. W. 16) gives as a reason for the rule enunciated, to the effect that a trustee cannot be permitted to make any profit out of his office, that the law will not permit the trustee to be placed in a position where his interest may be opposed to his duty.

In another case the same court (Lindsey *v.* Strong, 126 N. W. 941) observed that a trustee must act with the utmost good faith for the benefit of the beneficiary, and he may not manage the trust or deal with the trust estate so as to gain any advantage for himself.

The Indiana Supreme Court in Teegarden *v.* Lewis (145 Ind. 98) gave as the reason for the rule the superiority in position on the part of the trustee, and the weakness, partial incapacity or dependence upon the part of the *cestui que* trust.

But nowhere are the reasons for the rule more clearly and forcibly stated than by the New Jersey Court *In re* Hill's estate (82 Atl. 338). In that case the court spoke as follows:

> "The position of trustee is one of trust and confidence, and it is a fundamental principle in regard to trust estates that a trustee cannot use the trust property, nor his relation to it, for his own personal advantage. All the power and influence which the possession of the trust property gives must be used for the advantage and profit of the beneficial owners and not for the personal gain and emolument of the trustee (Perry on Trusts, 5th Ed., Sec. 427; 26 Ency. of Law, 2nd Ed., p. 1016; Bohle *v.* Hasselbroch, 64 N. J. Eq. 334; 51 Atl. 508; 61 L. R. A. 323).

* * * "It is ever the duty of the trustee to be alert in

the interests of the trust estate. When a person adopts the duties of trustee, he, in all his dealings with the estate, is required to make his own interests subordinate to the interstate of the estate. To such an extent is this duty impressed upon him by the courts that he is not permitted to put himself in a place where he may be deemed to advance his own interests over that of the trust estate. In Staats *v.* Bergin, 17 N. J. Eq. 544, the Court of Errors and Appeals laid down such duty in the following language: 'It is the universal rule that a trustee must not put himself in a position in which he will be deemed from the influence of self interest to take advantage of his *cestui que* trust.' And the late Chief Justice Beasley, in the opinion written in that case on this subject, states: 'The rule is one of public policy. The trustee is not prevented * * * on the ground simply of supposition, of actual fraud, but because the law has established as an inflexible rule, applicable to every emergency that he shall not place himself in a situation in which he will be deemed to take advantage of his *cestui que* trust. This is a wise public regulation, intended to protect a specific property, which otherwise would be constantly exposed to peculiar hazard. The trustee, therefore, must submit to this regulation, and if he does an act in violation of it, no matter how pure his intentions may be, such an act is voidable at the instance of the person whom he represents. * * * The *cestui que* trust is not bound to prove that the trustee has made a bargain advantageous to himself. The fact may be so, and yet the party not think it in his power distinctly and clearly to show it.

"The present case is perhaps a good illustration of how a trustee may be assumed to be perfectly innocent of any intention of using his influence as trustee for his own advantage, places himself in a position where by subsequent developments, he is enabled to pocket a profit which should have been turned into the estate. * * * The rule is inexorable. As was stated by the court in Staats *v.* Bergen, *ubi supra,* 17 N. J. Eq. 559, 'The rule to be efficacious must be general, and the law implies therefore that in all cases of trust such opportunities may exist, and consequently the prohibition is universal that he may not do anything which while it is an advantage to himself, is, or may be, a loss to the trust estate. So jealous is the law upon this point, that a trustee may not put himself in a position in which to be honest must be a strain upon him. The general rule, therefore, applies not merely in those

cases in which the confidence is absolutely betrayed, but when the circumstances are such that there was an attempt to violate it. The moral standard thus raised by the law in the administration of trust estates may be in advance of the ethical standard deduced from the average of commercial transactions, but there is no reason why it should be lowered or abandoned because in a given case the trustee may not be guilty of moral culpability.'"

In Frazer *v.* Jenkins (64 Kansas 615) the court spoke as follows:

"In fact, the main rule that a trustee may not profit himself out of the trust estate, is not better settled than the subsidiary one that lack of fraud in the trust dealings will not violate the transaction. The fiduciary relation of trustee and *cestui que* trust is one which does not call so much for to alter accomplished wrong, as for rules to prevent its accomplishment. The one in question, therefore, is not intended to be merely remedial of wrong actually committed, but rather to be preventive or detrimental in effect. The opportunities which are open to an unfaithful trustee to advantage himself out of the trust estate are so many and so admitted, and the condition of the beneficiary in the trust ordinarily so helpless and confiding that the law gives warning in advance against all transactions out of which it is possible for the former to make gain at the expense of the latter. Hence, as was tersely and wisely stated by Chief Justice Beasley in Staats *v.* Bergen, 17 N. J. Eq. 554, 'So jealous is the law upon this point that a trustee may not put himself in a position in which to be honest must be a strain upon him.'"

Before concluding this article it may be of no little value to call attention to cases where the general rule has been applied. A specific case directly in point is that of Jarrett *v.* Johnson (216 Ill. 212). In this case the court spoke as follows:

"This assignment raises the question whether it was error to require an accounting of the funds received by Koehler from the Cook County Brick Company. In holding such an accounting proper we think the decree was correct. The evidence shows that the amount paid by Koehler for the stock in the brick company, namely $225, for nine shares therefor, was not the real consideration therefore. The fact that Koehler was in possession of

> the brick plant as trustee for the creditors of Mayer & Towle, and could control it and leased it to the new company, was the real and true reason why the organizers of the Cook County Brick Company permitted Koehler to take stock in the brick company. The evidence shows that stock was sold by the said brick company only to the owners or lessees of brick plants. Had Koehler not been acting as trustee for the creditors of Mayer & Towle, he could not have been in possession of the brick plant, and no opportunity would have been offered him to take stock in the brick company. Whatever profits were made on the stock in the Cook County Brick Company were made for the creditors of Mayer & Towle, for whose use Koehler had the possession and management of the brick plant."

Attention is also called to the following cases:

The promoters of a bridge company, the only subscribers to its stock, agreed to assign to complainant certain interests therein. Thereafter two of them, officers of the company, made on its behalf a contract with a construction company, whereby that company for a specified sum in bonds of the bridge company and the entire amount of the stock subscribed, agreed to construct a bridge and furnish money to acquire land for approaches, and return to the subscribers a specified sum. At the same time the two officers agreed with the construction company for bonds of the bridge company and stock in the company, to procure and convey title to the lands needed for right of way. They reported the construction contract to their board of directors, but said nothing about the right of way contract. They afterwards procured the necessary lands, using only the company's bonds for that purpose and making a substantial profit in the transaction as they expected to do. It was held, that the officers were charged with a trust in behalf of the complainant, and could not derive an advantage to themselves to his prejudice, and therefore, the complainant was entitled to a decree requiring them to transfer his share of the stock. (Williamson *v.* Krohn, 66 Fed. 655; 13 C. C. A. 668; 31 U. S. App. 325.)

A trustee, who by reason of membership in an underwriter's association, obtains a commission on premiums paid to insure

the trust property must account therefor to the trust estate, he being entitled, however, to deduct his membership fees in the association. (Judgment, Sherman *v.* White, 1896, 62 Ill. App. 271; affirmed, White *v.* Sherman, 48 N. E. 128; 168 Ill. 589; 61 A. St. Rep. 132.)

A trustee in dealing with trust property demanded and obtained a certain six-acre tract of property to be reserved for and conveyed to him before he would sign necessary contracts of settlement with third parties for the *cestui que* trust. It was held, that this act was wrongful and the conveyance void. (Moore *v.* Moore, 1 Alaska 225.)

If a trustee receives a bonus for lending the trust funds, this of itself does not show bad faith, but he must charge himself with the bonus so received. Sherman *v.* Lanie, 39 N. J. Eq. (12 Stew.) 249.

In H. G. Machine Company *v.* Morris (N. J.) 89 Atl. 249, the court held as follows:

> "The principle is undoubtedly permanently fixed in our system of jurisprudence that where a trustee acquires information through the medium of his trust that enables him to acquire valuable property rights that are antagonistic to the interests of the *cestui que* trust whom he represents, a court of equity should restrain him from reaping personal benefits from such conduct and should also appropriate to and for the benefit of the *cestui que* trust any values or rights that have arisen in that manner."

In Nebraska Power Company *v.* Koenig (Neb.) 139 N. W. 842, the court spoke as follows:

> "Among the principles enforced by courts of equity in dealing with conduct growing out of relations of trust and confidence, are the following: Means and knowledge acquired by a trusted representative in performing the duties of his trust cannot be used by him to gain an individual advantage at the expense of his employer. In matters relating to the subject of a trust, the fiduciary acts for his principles alone."

A trustee will not be permitted to make profit for himself in managing the business of his *cestui que* trust, nor to put himself in any attitude inconsistent with the interests of his

trust, or which will tend to interfere with his duty in discharging it. Richardson's Adm'rs. *v.* Spencer, 57 Ky. (18 B. Mon.) 450.

One who occupies a fiduciary relation to another may not exercise any of his powers or rights or any advantage of any description derived from the fiduciary relationship for his own benefit, to the prejudice of the party to whom he stands in such relation. (Newcomb *v.* Brooks, 16 W. Va. 32.)

In Barney *v.* Sunders, *et al.* (16 How. 534), the court spoke as follows:

> "It is a well settled principle of equity that wherever a trustee or one standing in a fiduciary character, deals with the trust estate for his own personal profit, he shall account to the *cestui que* trust for all the gain which he has made. If he uses the trust money in speculations, dangerous though profitable, the risk will be his own, but the profits will inure to the *cestui que* trust. Such a rule, though rigid, is necessary to prevent malversation. (See Docker *v.* Sommes, 2 Myl. & K. 655.")

A trustee has no right to drive any benefit or advantage from the trust funds, but all his skill and labor in the management of it must be directed to the advancement of the interests of his *cestui que* trust. Arnold *v.* Brown, 41 Mass. (24 Pick.) 89, 35 Am. Dec. 296.

In Rouse *v.* Rouse (N. C. 83, S. E. 305) the court spoke as follows:

> "It is an invariable principle of equity and jurisprudence that a trustee cannot derive any profit or advantage from the sale of trust property committed to his guardianship, and all of the advantage which he might thus improperly acquire result to the benefit of the real beneficiaries of the trust."

From all the foregoing cases we derive the following rules covering the matter of the right of trustees to derive indirect profits from the handling of trust funds:

1. A trustee may not benefit directly in any manner by the use of the advantage of his trust position to gain any benefit for himself at the expense of his *cestui que* trust.

2. In administering the trust, the trustee must always act

in the interest of the beneficiaries of the trust and not for himself.

3. A trustee must never place himself in any position where his self interest may conflict with his duties as trustee.

4. Outside of his lawful compensation a trustee will not be permitted to derive any benefit out of the administration of his trust.

5. A trustee must account to his *cestui que* trust for any profits made by him out of the office of trustee or the use of trust funds.

6. A trustee will not be permitted to retain any benefit nor any bonus or present given him by third parties with whom he has had occasion to deal as trustee.

7. A trustee need not be guilty of actual fraud in order to violate the rule which forbids a trustee from making any gain or profit or advantage from the use of trust funds. This for the reason that the law forbids any inquiry into the honesty of a particular case. This rule is laid down to prevent secret frauds by removing of inducements to commit them.

8. Equity will hold a trustee to the highest standard of morality and equity in all his dealings with his *ces que* trust.

Finally, where a trustee receives gifts, presents or bonuses from any party with whom he has dealt in his capacity as trustee and for which he has not paid the full equity value, the court will presume that all such gifts, presents or bonuses were given to the trustee for the benefit of his *cestui que* trust, and will require the former to account to the latter therefor.

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